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American Bankers Association

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VIA ELECTRONIC MAIL

Mr. Joe Canary
Acting Director
Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Re: Public Hearing on Definition of Fiduciary

Dear Mr. Canary:

The American Bankers Association (ABA) appreciates the opportunity to provide comments to the Department of Labor (Department) in connection with the testimony provided at a two-day public hearing held in March 2011 (Hearing). The subject of the Hearing was the proposed rule regarding the expanded circumstances under which a person is considered to be a "fiduciary", under the Employee Retirement Income Security Act of 1974 (ERISA), when providing investment advice to an employee benefit plan or to a plan's participants (Proposal). ABA represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees. Many of these banks are plan service providers, providing trust, custody, and other services for institutional clients, including employee benefit plans covered by ERISA.

This response follows up to our letter of February 3, 2011, regarding the Proposal. In that letter we stated that, under the Proposal, a number of non-fiduciary services provided by bank custodians, directed trustees, and other service providers would or may be deemed to be "fiduciary" services, thus triggering ERISA fiduciary status for these entities where, in the performance of these services, investment advice has neither been rendered nor received.[1]

Having reviewed the Proposal and Hearing testimony, as well as a number of public comments on the Proposal, ABA wishes to reiterate that the Proposal is overbroad and significantly exceeds its intended reach. We believe, moreover, that the Department has conducted insufficient regulatory study and analysis, and has failed to consider less burdensome alternative proposals, to conclude reasonably that the Proposal's benefits justify its costs. Consequently, the Proposal, if adopted in its current form, will adversely impact the very participants, beneficiaries, and account holders that it is intended to protect by making it difficult, burdensome, and costly for banks to deliver the services and information that are necessary, helpful, or appropriate for a financially sound retirement.

[1] Please refer to our letter of February 3, 2011, for a detailed analysis of these services.

Assistant Secretary Phyllis Borzi opened the Hearing by stating, "[I]t's vitally important when we define important terms, like who is a fiduciary, we get it right."[2] We agree. In doing so, it is critical that the Department's rulemaking process be accomplished thoughtfully and thoroughly, using a wealth of collected data, to justify a foundational shift (with significant and lasting effects) in the ways in which business is conducted under ERISA. Federal law requires nothing less. Unfortunately, the nature, extent, and depth of regulatory study and analysis performed by the Department in fashioning the Proposal fails to meet this standard. Indeed, the Department's failure to craft the Proposal in conformity with substantive procedural requirements governing agency rulemaking exposes the Department to a possible violation of the Administrative Procedure Act (APA).

We request, therefore, that the Department withdraw the Proposal, conduct appropriate additional regulatory studies and analyses, draw up and duly consider regulatory alternatives that are less burdensome and costly, and submit for public review and comment an amended Proposal that is both narrowly and appropriately targeted to achieve the Department's regulatory objectives.

Please note that this letter is in addition to our previous comments and is in no way intended to change, modify, or supersede them. We also wish to reserve the opportunity to comment further on the Proposal after we have carefully reviewed and analyzed the pending regulatory actions of other federal agencies and self-regulatory organizations regarding fiduciary standards.

I. The Proposal is Inconsistent with the Directives of Executive Orders 13563 and 12866.

The Department published the Proposal on October 22, 2010. Three months later, President Obama later issued Executive Order 13563, "Improving Regulation and Regulatory Review." Executive Order 13563 reiterates the principles of Executive Order 12866 (signed by President Clinton in 1993) governing federal regulation and the regulatory review process. In issuing Executive Order 13563, President Obama stated:

> "Our regulatory system must . . . *promote predictability and reduce uncertainty*. It must identify and use the best, most innovative, and *least burdensome tools* for achieving regulatory ends. . . . As stated in [Executive Order 12866] and to the extent permitted by law, each agency must, among other things: (1) propose or adopt a regulation *only upon a reasoned determination that its benefits justify its costs* . . ."[3]

[2] Statement of Phyllis Borzi, Assistant Secretary, Employee Benefits Security Administration, U.S. Department of Labor (Mar. 1, 2011).
[3] Executive Order 13563 (Jan. 18, 2011). [Emphasis added.]

Following the release of Executive Order 13563, ABA President and CEO Frank Keating wrote Labor Secretary Hilda Solis supporting the President's order on regulatory burden and requesting that the Department, in connection with the President's order, be mindful of the regulatory burdens imposed by re-defining "fiduciary" under ERISA and to coordinate its efforts with the other relevant agencies.[4]

Regrettably, the Proposal falls short of the stated objectives of Executive Order 13563. In particular, it does not appear that the Department has employed the "least burdensome tools" to achieve its objectives, or that the Department has reasonably determined that the Proposal's benefits to plans and their participants and beneficiaries justify the enormous costs imposed on industry participants.

In releasing Executive Order 13563, President Obama stated that "[w]e are seeking *more affordable*, *less intrusive* means to achieve the same ends, *giving careful consideration to benefits and costs*."[5] Rather than providing "more affordable, less intrusive means," the Proposal dramatically <u>expands</u> the applicability of the highest and most restrictive standard of fiduciary conduct under federal law (<u>i.e.</u>, ERISA) to <u>entire</u> classes of market participants never before considered as ERISA fiduciaries. The Department's objectives, in issuing the Proposal, focuses on holding accountable certain pension consultants and appraisers who have provided substandard services or misleading valuations, or who have failed to disclose conflicts of interest. Under the Proposal, however, bank custodians, directed trustees, broker-dealers, and other service providers may be deemed fiduciaries for services that the Department has traditionally considered to be non-fiduciary. The Department has not provided any explanation, nor has it conducted or cited any study, survey, analysis, or series of agency reviews or examinations, that has raised concerns of abuse or malfeasance over the practices of these non-fiduciary providers, or that would otherwise justify such providers being summarily swept into the Proposal's fiduciary definition. In this vein, the Department's actions are inconsistent with the directive of Executive Order 13563: "[be]fore issuing a notice of proposed rulemaking, each agency, where feasible and appropriate, <u>shall</u> seek the views of those who are likely to be affected, including those . . . who are potentially subject to such rulemaking."[6]

Thus, the Department should have sought the views of banks whose activities touch on the Department's objectives in issuing the Proposal. Withdrawing the Proposal will provide for such an opportunity.

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[4] Letter from Frank Keating, ABA President and CEO, to Hilda J. Solis, U.S. Secretary of Labor (Jan. 24, 2011).
[5] President Barack Obama, "Toward a 21st Century Regulatory System," *Wall Street Journal* (Jan. 21, 2011).
[6] Executive Order 13563. [Emphasis added.] Although the Proposal was issued before Executive Order 13563, the Department's obligation is to seek input from those persons and entities likely to be impacted by the Proposal. We are not aware of any Department efforts, prior to the Proposal's issuance, to study, survey, analyze, or evaluate the banking industry's provision of services to the retirement industry that are directly or indirectly impacted by the Proposal. The testimony provided by the Hearing, while helpful, provides only a small snapshot of the issues and challenges raised by the Proposal and cannot serve as an ex post facto substitute for the research and analysis necessary *before* a proposed rule of this magnitude and impact is issued.

II. The Proposal Does Not Adequately Identify or Address Regulatory Burdens and Costs.

Furthermore, in its regulatory analysis, the Department does not fully or realistically quantify the Proposal's burdens and costs. For example, while extending the Proposal's applicability to IRAs, the Department has conducted no study or survey, and has provided no data, on the impact of the Proposal on the IRA marketplace and its business participants. Given the sheer size of the regulated universe, with approximately $10 trillion held by ERISA plans and IRAs, even a small fraction of service providers susceptible to compliance, business model restructuring, contract review, liability insurance, transition, and other expenses could result in extraordinarily high costs to the retirement industry, much of which may be passed on to plans and their participants and beneficiaries.[7] Alternatively, the onerous costs could cause a number of these service providers to exit the business, with adverse impacts on customers and reduced competition in the marketplace, thereby further increasing the costs to consumers.

Given the absence of industry study, surveys, and data, it is not surprising that the Department concludes that it is unable to quantify the costs of the Proposal. It simply concedes that "this rule could have a large market impact."[8] In a series of statements, the Department admits the uncertainty of potentially significant or prohibitive costs: under the Proposal, it "is uncertain regarding whether, and to what extent, service provider costs would increase," it "is unable to estimate the increased business costs small entities would incur if there were determined to be fiduciaries under the proposal," and it "is uncertain regarding the number of transactions that would have to be restructured."[9] During the Hearing, Department staff hinted that more groundwork could have gone into the Proposal prior to its issuance: "[There are] areas where we [the Department] can strengthen the impact analysis that we've undertaken so far. . . . [W]e really would benefit the public by further explaining some of our thinking and maybe digging deeper in some places."[10]

The Proposal seeks a fundamental re-structuring of fiduciary relationships under ERISA. In its Notice of Proposed Rulemaking (NPR), the Department declares that it "is confident that adopting a new definition of the term 'fiduciary' should discourage harmful conflicts of interest, improve service value, and enhance the Department's ability to redress abuses and more effectively and efficiently allocate its enforcement resources." Yet in the next sentence the

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[7] The Department estimates that the industry costs of implementing the Proposal over the first ten years will be in an amount up to $17.8 million. We believe this amount is extremely modest and fails to take account of numerous other costs mentioned above. It is incumbent on the Department, among other things, to conduct research and study of the probable costs of the Proposal on service providers and the retirement industry in order to arrive at much more realistic (and, we believe, significantly higher) industry costs prior to finalizing the Proposal in its current or amended form.

[8] 75 Fed. Reg. 65,275-76 (Oct. 22, 2010).

[9] *Id*.

[10] Statement of Joseph Piacentini, Director, Policy and Research, Employee Benefit Security Administration. Mr. Piacentini added: "I do want to get on the record by way of observation that, you know, certainly it is our intention to satisfy the requirements of the applicable Executive Orders and other applicable requirements when we do our analyses and I think we crossed that threshold this time but that doesn't mean that there's not always room for improvement." *Id*.

Department acknowledges that "it is uncertain about the magnitude of these benefits and potential costs." Given the certain magnitude of its *effects*, the burden is on the Department to consider duly the information and data necessary to provide some reasonable basis for the Proposal. OMB Circular A-4 requires agencies to take this step:

> "When uncertainty has significant effects on the final conclusion about net benefits, your agency *should consider additional research prior to rulemaking*. The costs of being wrong may outweigh the benefits of a faster decision. This is true especially for cases with irreversible or large upfront investments. *If your agency decides to proceed with rulemaking, you should explain why the costs of developing additional information . . . exceed the value of that information.*"[11]

No such explanation has been given. Instead, the Department "tentatively concludes that the proposed regulation's benefits would justify its costs."[12] The Department's actions, however, make it difficult to conclude that the Department scrupulously weighed the Proposal's costs in conformity with regulatory requirements

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III. The Proposal Fails to Consider Regulatory Alternatives.

Finally, the Department has inadequately considered regulatory alternatives to the Proposal. In the NPR, the Department identified only two possible regulatory alternatives to the Proposal: (1) replacing the current regulatory definition with the language of section 3(21)(A)(ii) of ERISA; and (2) omitting an explicit limitation to service providers offering a "platform" of investment options. The first alternative merely parrots the language of the statutory definition, and therefore, would contribute nothing toward regulatory predictability and certainty.[13] The second alternative affects only a small portion of the available limitations and does not address the sweeping nature of the Proposal itself. Conversely, the Department has not considered any regulatory alternatives that would narrowly tailor the Proposal's reach to the prime culprits – pension consultants with undisclosed conflicts of interest and appraisers providing unreliable valuation opinions.[14]

The Department has yet to provide any explanation why nothing less than the full scope of the Proposal would work, undercutting its efforts to justify the Proposal's regulatory burdens and costs. Instead, the Department considered only two regulatory alternatives, each of which would have *expanded* the breadth of the Proposal, while failing to consider *less* burdensome and costly alternatives. This approach appears to conflict with the directives of Executive Orders 13563 and 12866 and the interpretive guidance laid out in Circular A-4, the latter which advises agencies as follows:

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[11] OMB Circular No. 4, p. 39. [Emphasis added.]
[12] 75 Fed. Reg. at 65,275.
[13] The Department itself acknowledged that "this approach would not provide sufficient clarity for persons to determine whether they are ERISA fiduciaries." See 75 Fed. Reg. at 65,275.
[14] See 75 Fed. Reg. at 65,271.

> "In general, both the benefits and costs associated with a regulation will increase with the level of stringency . . . You should study alternative levels of stringency to understand more fully the relationship between stringency and the size and distribution of benefits and costs among different groups. [. . .]
>
> "You should carefully consider *all* appropriate alternatives for the key attributes or provisions of the rule. . . . [Y]ou generally should analyze at least three options: the preferred option; a more stringent option that achieves additional benefits (and presumably costs more) beyond those realized by the preferred option; *and a less stringent option that costs less* (and presumably generates fewer benefits) *than the preferred option*."[15]

Consistent with this guidance, the Department, prior to issuing the Proposal, should have examined one or more regulatory alternatives of *lesser* stringency in order to determine whether such alternatives would enable the Department to achieve its objectives with fewer regulatory burdens and costs. By not doing so, and by failing to conduct *any* study or analyses of the Proposal's costs to the retirement industry and the IRA marketplace, the Department has contravened the intents and purposes of Executive Orders 13563 and 12866 and requirements of OMB Circular A-4, and thereby risks running afoul of the Administrative Procedure Act's provisions governing judicial review of agency rulemaking.[16]

IV. Conclusion.

We commend the Department for seeking to strengthen the standards of business conduct under ERISA by targeting certain professionals whose misconduct negatively impacts the interests of plans and their participants and beneficiaries. We are further encouraged by the Department's efforts to solicit public responses and input to the Proposal through the rulemaking process and Hearing. We continue to believe, however, that the Proposal is significantly overbroad and captures persons never intended to be included as ERISA fiduciaries. We further believe that the Proposal has been issued without adequate research and analysis on the Proposal's burdens and costs. In so doing, the Department has failed to consider less burdensome alternative proposals in conformity with regulatory requirements.

The Department, therefore, should withdraw the Proposal, conduct substantive studies and surveys that thoroughly examine and reveal the Proposal's burdens and costs, draw up and consider alternative proposed rules that would achieve its objectives with substantially reduced regulatory burdens and costs, and issue an amended Proposal for public comment. Throughout this review process, the Department additionally should consult and coordinate with the other federal agencies and self-regulatory organizations in order to ensure consistent and non-conflicting fiduciary regulations and requirements. We support the Department's goal of curbing abuses in the retirement industry and would be glad to assist the Department in its efforts to lay

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[15] OMB Circular A-4 (Sept. 17, 2003), p. 8.

[16] See Administrative Procedures Act, 5 U.S.C. §§ 706(2)(A) (APA violation if regulatory rulemaking is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law") and 706(2)(D) (APA violation if rulemaking is done "without observance of procedure required by law").

the groundwork for an amended Proposal that would succeed in attaining its objectives while minimizing regulatory burdens and costs.

If you have any questions, please do not hesitate to contact me at 202-663-5479.

Sincerely yours,

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